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FCC 94-286

**Before the**
**FEDERAL COMMUNICATIONS COMMISSION**
**Washington, DC 20554**

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| In the Matter of | |
| Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation | MM Docket No. 92-266 |
| Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation | MM Docket No. 93-215 |

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**COMMENTS OF UNITED VIDEO**

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## SUMMARY

In this proceeding the Commission is considering eliminating the current 7.5% markup on programming cost increases for channels offered on cable systems before May 15, 1995. At this time there is absolutely no evidence to support the proposed change. Maintaining existing policy regarding the 7.5% markup benefits cable operators, cable programmers and cable subscribers. At a minimum, the 7.5% markup should be retained for superstations. The Commission's decision in this proceeding must consider the very difficult economic conditions that exist in the interdependent programming and cable industries.

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To: The Commission

**COMMENTS OF UNITED VIDEO**

These comments are submitted by United Video[1] in response to the Commission's *Seventh Notice of Proposed Rulemaking* in the above-captioned proceeding in which the Commission is considering eliminating the current 7.5% markup on programming cost increases for channels offered on cable systems before May 15, 1994. For reasons discussed below, retaining the 7.5% markup will serve the public interest by allowing some limited flexibility for cable operators to enable both the programming and cable industries to grow and improve service to the public, thus fulfilling one of the primary objectives of the

[1] United Video is a division of United Video Satellite Group which distributes superstations WGN, KTLA and WPIX to cable systems and other facilities-based technologies throughout the country.

1992 Cable Act to "assure that cable communications provide and are encouraged to provide the widest possible diversity of information sources and services to the public." 47 USC 521(4) (emphasis added).

There is simply no evidence of any need to make this additional change in the rate regulations. The Commission can revisit this issue at any time in the future if a change proves to be necessary. The 7.5% markup on program cost increases is insignificant from the standpoint of the individual subscriber, but is critical to the ability of programmers to ensure that consumers will have access to the widest possible range of quality programming.

In this proceeding the Commission has a clear choice: it can retain the existing 7.5% markup and begin to minimize regulatory interference in the marketplace, or it can make yet another change in its rate regulations, that can only be viewed as micromanaging and unnecessarily restricting the cable and programming industries.

## I. THE COMMISSION'S DECISION IN THIS PROCEEDING MUST CONSIDER CURRENT CONDITIONS IN THE INTERDEPENDENT PROGRAMMING AND CABLE INDUSTRIES

### A. Upheaval in Programming Industry

The 7.5% markup, which applies to program cost increases is an important component of the FCC's regulatory scheme for the cable and programming industries. Eliminating the 7.5% markup at this time must be considered in light of the tremendous upheaval which has occurred in the cable industry and by association, the programming industry.

Not only are the programmers affected by the FCC-imposed downturn in the cable industry, they have also been directly impacted by rate regulation and must carry requirements imposed by the Commission under the 1992 Cable Act. Programmers' sales figures and penetration levels since implementation of the 1992 Cable Act have seen little increase after more than a decade of steady growth. On a number of cable systems United Video's superstation services have been migrated from regulated tiers to a la carte tiers resulting in lower penetration levels and a reduction in subscribers. The Commission's recent resolution of the a la carte cases sanctioned most of these arrangements. Moreover, the long delay in issuing going-forward rules and incentives stalled the continuing development of the program industry, as cable operators waited to determine whether they would be able to add programming on any reasonable basis. While decisions on the regulations were pending before the Commission, cable operators would not even consider the prospect of adding services to their systems. The folding of some new programming services and launch delays of others have been attributed to the delay in issuing the going-forward rules.

Programmers have also been directly affected by the substantial consolidation in the cable industry. The rash of merger and acquisition activity has occurred in large part due to FCC regulation. This consolidation is moving much more quickly than the Commission has recognized. In 1990 the top ten MSOs represented 22.0% of United Video's WGN subscriber base. In 1994 the top ten MSOs represented 54% of United Video's subscriber base. The net effect has been an effective decrease in revenues as a result of the drastic increases in number of cable households falling under volume-pricing discounts on programming. These revenue decreases have not been offset by any corresponding increase in the overall number of WGN subscribers. Moreover, there is every indication that consolidations will continue at an accelerated pace, which will continue to impact the basic economics of United Video's operations.

Since 1978 United Video has utilized satellite technology to make superstations available to cable systems and other facilities-based technologies. Today United Video's services are available to over 100 million households and actually received by more than 40 million households. Market research indicates that cable operators and the 60 million households currently not receiving superstations want to receive them. These numbers demonstrate that there is room for future growth of United Video's superstation services. That growth in the subscriber base serves the interest of consumers as well.

United Video has avoided rate increases during its sixteen years of superstation distribution, even though its costs have increased annually. The company has been able to offset its increased operating costs through increased revenues resulting from subscriber growth. The Commission's restrictions on rates and programming are imposing an artificial constraint in the marketplace, and stifling growth of the programming industry to the detriment of consumers. The slow growth of United Video's services since enactment of the 1992 Cable Act is particularly frustrating since the superstation services are extremely popular with cable operators and subscribers. Constant changes in the rate regulations, such as the proposed elimination of the 7.5% markup, has caused serious disruption from regulatory interference with the marketplace.

## B. The Cable and Programming Industries are Interdependent

United Video's growth and that of other programmers is inextricably linked to the fortunes of the cable industry. Unless cable operators have flexibility to add program services to existing channel lineups either by substitution of services or by expansion of available channel capacity, there will be little growth in the programming business. The Commission's recent decision not to permit rate increases to facilitate cable system rebuilds and channel expansion compounds this problem. While the 7.5% markup is by no means a substitute for rebuild incentives, it will provide some help for operators who are attempting to rebuild their systems. Without the markup, the increase in channel capacity from rebuilds will be much slower.

The lack of channel capacity is particularly troubling in light of the tremendous popularity and strong consumer demand for United Video's superstation services. Government regulations should not interfere with marketplace decisions. While the "going-forward" regulations are a step in the right direction, the Commission should use this proceeding as an opportunity to do more, or at a minimum, do no further harm.

## II. MAINTAINING EXISTING POLICY REGARDING THE 7.5% MARKUP BENEFITS CABLE OPERATORS, CABLE PROGRAMMERS AND CABLE SUBSCRIBERS

The 7.5% markup is extremely small and will result in only negligible adjustments to a consumer's bill.[2] Moreover, due to competition from direct-to-home satellite services and other sources, the assumption the Commission has made that cable operators will constantly maximize their rates is no longer valid, if it ever was. Rate increases in the cable industry are limited, not only by Commission regulation, but also by competition and recognition by cable operators that they must maintain their customer base as well as the goodwill of their subscribers. Cable operators are not in a position to raise rates unless the increase is necessary. Thus the 7.5% merely provides some very limited but needed flexibility for cable operators, particularly those "good actors" with artificially low rates who are now caught in the web of FCC regulation.

On the other hand, consumers will benefit to the extent that the 7.5% collectively provides some revenue and incentive for cable operators to offer the widest possible range of programming and make system improvements. Moreover, to remain viable programmers need sufficient revenue to cover the increased costs of doing business in the highly competitive market for program services and to maintain the quality of their product. However, because of the current economic conditions in the cable industry, cable operators

[2] Even if rates for a programming service increased several cents per month, which was passed through by the cable operators, the 7.5% markup would amount to a fraction of a penny for each subscriber.

are reluctant to pay programmers any rate increases, even if they can be passed through to subscribers. The 7.5% markup gives cable operators some incentive to accept reasonable increases that are absolutely necessary for the programmers.

The 7.5% is also necessary to cover administrative costs and other unreimbursed costs incurred by cable operators in connection with timing of rate increases. If a cable operator elects to pass through to subscribers an increase in the cost of a program service, there are very real administrative expenses including printing and mailing of notices, explaining the increase to subscribers and local authorities, and obtaining any necessary regulatory approvals. Furthermore, as a practical matter, there is often significant lag time between the date of a cost increase and the date it is actually passed through to subscribers. Not only can subscriber rate increases be delayed by regulatory authorities in certain circumstances; the marketplace itself does not permit a cable operator to raise rates more often than once or twice a year. These costs are not reimbursed by rate adjustments for inflation or other pass throughs of external costs. Thus as a practical matter, the 7.5% markup may in fact be insufficient for a cable operator to recover from subscribers all of the real costs associated with most programming cost increases.

It is inappropriate for the Commission to continue to limit the flexibility of cable operators to adjust rates, particularly now when the Commission has just announced its intention not to permit cable operators to increase rates to provide for rebuilding and expansion of cable plant and services. Although the 7.5% markup will provide only limited revenue to the cable operator, it is necessary for cable operators who must attempt to demonstrate to lending institutions that their revenues are sufficient to fund the lending that will be essential for system rebuilds to enable the cable industry to compete with other video delivery services.

Finally, contrary to the Commission's suggestion in the NPRM, the 7.5% markup will not create an artificial incentive for the cable operator to continue to offer programming that it would otherwise terminate. One result of the Commission's going-forward rules is to freeze current channel line-ups on the basic and cable programming service tiers, since migrating services to the "new product tier" is generally prohibited and operators only receive the launch incentives when they add channel capacity to accommodate new services. United Video believes that the 7.5% markup could actually encourage operators to substitute better quality programming on their cable systems. In addition, it will discourage cable operators from bringing in low-cost and low-quality services to replace more costly existing services since under the current rules the cable operator's cost reduction plus 7.5% must be passed through to subscribers. Thus, with the 7.5% markup (and markdown) in place, the cable operator would actually lose money by replacing existing quality programming with low-cost substitutes.

## III. AT THIS TIME THERE IS NO EVIDENCE TO SUPPORT THE PROPOSED CHANGE

The 7.5% markup on programming cost increases for channels offered before May 15, 1994 has been in effect for only a few months since the effective date of FCC Form 1210. Furthermore, the Commission's "going-forward" rules relating to the addition of programming became effective less than two weeks ago. Neither the Commission nor the cable industry has had sufficient time and experience under these going-forward rules to determine whether they will be sufficient to enable cable operators to offer the maximum in program choice for subscribers. At such time as the Commission determines that there is a demonstrated need to change this or any other rate regulation, it can do so. But particularly in view of the economic problems caused by regulatory interference with the cable and programming industries, there is simply no reason to turn the screws even tighter at this time. Although United Video is optimistic that the going-forward rules will begin to reverse the slow growth trends of the last two years, it remains to be seen whether that will be the case. Accordingly, eliminating the 7.5% markup at this time is premature.

## IV. AT A MINIMUM, THE 7.5% MARKUP SHOULD BE RETAINED FOR SUPERSTATIONS

United Video believes that the 7.5% markup should be retained for all program services. If, however, the Commission decides to proceed with elimination of the markup, it is critical that the markup be retained for superstations, which are unique and face unique regulatory barriers. Unlike other programming services, superstation carriers cannot waive or postpone programming fees in order to encourage a cable operator to carry the service. Programming costs for superstations include statutorily imposed copyright fees, which are calculated through complicated formulas and cannot be negotiated down, postponed or suspended. Superstation carriers are also prohibited from offering cable operators local advertising avails as a means to offset program cost increases since copyright law prohibits cable operators from inserting local advertisements on a superstation signal. Finally, superstation carriage has been artificially restricted through imposition of a copyright surcharge in many cable markets. Superstations, just like other program services, are not immune to increase of operating costs. Some of the increases in operating costs result from competing with other program services, changes in the marketplace, replacement of satellite transponders, and increased legal regulatory burden.

Furthermore, unlike new program services, which can establish their rates based on current trends in the industry, established services such as United Video's must attempt to revise their rates after the fact. For superstation services this is even more difficult because of the constraints discussed above. In the current environment, cable operators are simply unwilling to accept rate increases unless absolutely necessary for superstations or any other programming services. Thus, the 7.5% markup is essential for superstations as the only incentive for cable operators to accept necessary programming cost increases.

Superstations are an essential television service in many cable households. They give consumers access to a broad range of news, sports and entertainment programming that would not otherwise be available in their local television market. Moreover, United Video through its community affairs projects and cable in the classroom participation provides cable systems and their subscribers access to public service projects of particular interest to their local communities.[3] In many cases, the size of the cable system and the lack of other available resources in the community would make participation in such efforts difficult if not impossible.

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[3] United Video's "Space Camp" contest provided school-age children around the country with an opportunity to learn about space and attend space camp. The company's recently launched "Find Yourself in a Book Campaign" is helping local communities promote interest in reading among teens.

United Video has distributed superstations to cable operators via satellite since 1978 and has never increased its rates. The Commission's regulations should not limit United Video's flexibility to respond to changing market conditions resulting from cable industry consolidation and implementation of the 1992 Cable Act.

## CONCLUSION

The last two years have witnessed an unprecedented transformation in the cable television industry. Contrary to the current de-regulatory trend, the cable and programming industries have become one of the most heavily regulated industries in the country. The Commission's regulatory scheme has irreparably interfered with and distorted cable operators' programming decisions. The Commission can begin to reverse this trend by retaining the existing 7.5% markup on program cost increases. This action will benefit not only cable operators and programmers, but cable subscribers as well.

Respectfully submitted,

**UNITED VIDEO**

By: ______________________

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January 13, 1995

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